

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF NORTH CENTRAL)
TELEPHONE COOPERATIVE, INC. FOR)
AUTHORITY TO ADJUST ITS RATES) CASE NO. 8864
AND CHARGES)

O R D E R

On June 30, 1983, North Central Telephone Cooperative, Inc., ("North Central") filed an application with the Commission to increase its rates and charges for telephone service after July 20, 1983. North Central proposed its increase in two phases, a phase I increase of \$526,230 effective July 20, 1983, and a phase II increase of an additional \$316,717 effective July 20, 1984. North Central stated in its application that the two-phase rate increase would reduce long-term rate case expense and lessen the effects of sudden marked increases to its customers. On July 5, 1983, the proposed rates and charges were suspended for 5 months after July 20, 1983.

On October 18, 1983, the Commission held a public hearing to determine the reasonableness of North Central's request. The Consumer Protection Division of the Attorney General's Office intervened and participated in the hearing. All requested information has been received by the Commission.

In this Order the Commission has allowed increased revenues of \$473,442 but has denied North Central's proposed 2-phase rate.

BACKGROUND

North Central is a Tennessee Corporation established by and under the laws of the State of Tennessee and domiciled in the Commonwealth of Kentucky. North Central's books are not maintained on a jurisdictional basis, thus the net investment rate base and the Capital Structure established herein are based on the total operations without regard to the portion of the operations within the confines of the Commonwealth of Kentucky and the jurisdiction of the Kentucky Public Service Commission. However, North Central has previously indicated that the rates for service have been and will continue to be the same for subscribers in Kentucky and Tennessee. Tennessee does not exert jurisdiction over North Central and, accordingly, the rates set herein will apply to the consumers in both states. The Commission is, therefore, of the opinion that it is in the best interests of the subscribers of North Central to continue to determine the elements of value and the revenue requirements on a total company basis because separation of jurisdictional cost elements would not be cost justified and would most likely produce the exact or very similar results as those derived herein. The Commission may, however, require North Central in future rate cases to provide a detailed jurisdictional allocation of the cost of providing service to the Kentucky portion of its operations with sufficient supporting documentation and justification.

TEST PERIOD

North Central proposed and the Commission has accepted the 12-month period ending December 31, 1982, as the test period in this matter.

VALUATION METHOD

Net Investment Rate Base

North Central's adjusted net investment rate base at the end of the test period, is as follows:

Telephone Plant in Service	\$ 25,646,679
Telephone Plant Under Construction	<u>46,682</u>
Subtotal	\$ 25,693,361
Less Accumulated Depreciation	<u>3,475,403</u>
Net Plant	\$ 22,217,958
Materials and Supplies	<u>56,809</u>
Net Investment Rate Base	<u>\$ 22,274,767</u>

The Commission has included the plant classified as plant under construction on December 31 in adjusted telephone plant in service. This adjustment is discussed in a subsequent section of this Order.

Capital Structure

The Commission finds from the 1982 annual report that North Central's total capital at the end of the test period was \$22,788,176 and consisted of \$1,406,548 in equity and \$21,381,628 in long-term debt outstanding to the Rural Electrification Association ("REA").

The Commission has given due consideration to North Central's capital structure, net investment rate base and other

elements of value in determining the reasonableness of the rate increase requested herein.

REVENUES AND EXPENSES

North Central had net income of \$129,934 for the test period. In order to reflect expected operating conditions subsequent to completion of construction projects, all of which were placed in service by March 1983, North Central proposed numerous adjustments to revenues and expenses resulting in an adjusted net loss of \$209,514. The Commission notes that the proposed adjustments to depreciation expense and property tax expense were based upon the inclusion of post test period additions to plant to reflect the conversion to one-party service in adjusted operations. The Commission's normal policy is to reject such adjustments because the inclusion of additions to plant outside of the test period could have the effect of distorting the test period level of earnings. However the Commission is of the opinion that adherence to its normal policy of disallowing post test period additions would be detrimental to North Central in this case, because failure to include these effects would result in serious erosion of North Central's financial position due to the magnitude of plant additions. North Central also proposed a corresponding revenue offset to reflect normalized revenue after the conversion to one-party service. Thus, the Commission is of the opinion that the proposed adjustments to revenues, depreciation expense, and tax expense are in conformity with the principles of matching test period revenues, expenses and capital and that these adjustments and the related additions to plant in service should

be included in adjusted operations. Furthermore, the Commission finds North Central's proposed adjustments to be generally proper and has accepted them for rate-making purposes with the following exceptions, resulting in an adjusted net operating loss of \$156,726:

Depreciation Expense

North Central adjusted depreciation expense by \$194,328 to reflect additional depreciation from the construction projects which were completed by the end of the test year and were added to plant in service by March 31, 1983.^{1/} North Central's consultant, Mr. M.D. Coleman, testified that the plant additions resulted in the retirement of a portion of the previously used and useful plant in service. Mr. Coleman further testified that the pro forma depreciation reflected retirements through December 31, 1982. Because a significant amount of plant was replaced between December 31, 1982, and March 31, 1983, the Commission is of the opinion that proper depreciation expense would reflect retirements through March 31, 1983. North Central subsequently informed the Commission that \$513,481 of plant was retired in the period in question.^{2/} The Commission has therefore decreased North Central's pro forma depreciation expense by \$23,365^{3/} using the depreciation rates in North Central's application, to reflect adjusted depreciation expense of \$1,023,855 on plant used and useful after addition of the upgraded plant and retirement of the old plant.

Advertising Expenses

North Central's test period operations included \$2,284 of advertising expenses. Examples of this advertising indicate that the majority of this expense was for institutional advertising. North Central was asked but failed to quantify the amount of informational advertising as opposed to institutional advertising included in advertising expense.^{4/} It is the Commission's policy to disallow institutional advertising expenses for rate-making purposes. Therefore, the Commission is of the opinion that operating expenses should be reduced by \$2,284 as North Central has failed to justify any of these expenses as proper rate-making items.

Station Connection Expenses

North Central included in test period operations the increased expense associated with the expensing of station connections. This issue as it concerns North Central is being addressed in Case No. 8346 (Application of North Central Telephone Cooperative, Inc., to Consider Charges with Respect to the Expensing of Station Connections Resulting from the Amendment of the Uniform System of Accounts). Consequently, the increased expense for station connections of \$27,139 has been removed from test period operating expenses.

Therefore, the adjusted operations of North Central are stated as follows:

	<u>Proposed</u>	<u>Adjustment</u>	<u>Adjusted</u>
Operating Revenues	\$3,591,783	\$ -	\$3,591,783
Operating Expenses	<u>3,075,050</u>	<u>(52,788)</u>	<u>3,022,262</u>
Net Operating Income	516,733	52,788	569,521
Other Income	65,544	-	65,544
Fixed Charges	<u>791,791</u>	<u>-</u>	<u>791,791</u>
Net Income (Loss)	<u>\$ (209,514)</u>	<u>\$ 52,788</u>	<u>\$ (156,726)</u>

REVENUE REQUIREMENTS

The Commission has consistently determined revenue requirements for telephone cooperatives based on a return on net investment rate base and a times interest earned ratio ("TIER"). The Commission determines the TIER based upon the calculation provided in the REA mortgage agreement, section 5, which bases the coverage on net income before interest charges.

In this application, as stated previously, North Central proposed a rate increase in two phases. The phase I increase, which under North Central's proposal would remain in effect for 1 year, was based upon a TIER of 1.4X. Phase II, which was proposed to be effective 1 year from the effective date of phase I, was based on a TIER of 1.8X. North Central's lender, REA, requires a TIER coverage of 1.5X for the best 2 out of 3 previous years. In 1981, North Central's TIER was 1.13X. Based on unadjusted 1982 actual operations, North Central's TIER was 1.17X. Thus, North Central has failed to meet REA's TIER requirements for the last 2 years. The Commission is of the opinion that the present TIER coverage is clearly inadequate and is unfair, unjust, and unreasonable. Further the Commission is of the opinion that North Central's proposed TIER of 1.4X should be granted because the

additional revenues of \$473,442⁵/ will improve North Central's financial position. The Commission notes that this coverage will again place North Central in technical default on its debt requirements, and urges North Central to take the necessary steps to comply with REA requirements. However, the Commission is further of the opinion that North Central's two-phase rate proposal is inappropriate as operating conditions could change significantly from the date of this Order over the next annual period, resulting in totally different revenue requirements than those proposed by North Central in phase II. The phase-II rates proposed by North Central are therefore denied herein.

RATE DESIGN

North Central did not propose any change in rate design. The additional revenue requirement has been allocated to exchange access and coin telephone service. This method of allocation was proposed by North Central and the Commission finds no objection to it. Coin telephone service is being increased to 25 cents per call from 10 cents per call to maintain state uniformity on coin telephone charges.

SUMMARY

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The rates and charges in Appendix A are the fair, just and reasonable rates and charges for North Central to charge its customers for telephone service and will produce gross annual operating revenue of \$4,065,225.

2. The rates and charges proposed by North Central, insofar as they differ from those in Appendix A, should be denied upon application of KRS 278.030.

IT IS THEREFORE ORDERED that the proposed rates and charges in North Central's notice of June 30, 1983, be and they hereby are denied.

IT IS FURTHER ORDERED that North Central be and it hereby is authorized to place into effect the rates and charges in Appendix A for all service rendered on and after December 20, 1983.

IT IS FURTHER ORDERED that, within 30 days of the date of this Order, North Central shall file its tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 20th day of December, 1983.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

FOOTNOTES

1. Transcript of Evidence ("T.E."), pages 20-21.
2. Response filed November 1, 1983, item 3.
3. Calculation:

	<u>Amount</u>		<u>Rate</u>	<u>Expense</u>
Central Office Equipment	\$478,936	X	(.045)	\$21,552
Station Apparatus	8,504	X	(.05)	425
Station Connections	7,818	X	(.05)	391
Pole Line	7,255	X	(.04)	290
Aerial Wire	10,558	X	(.067)	707
				<u>\$23,365</u>

4. T. E., page 19.
5. Calculation:

$$\begin{aligned}
 \text{TIER} &= 1.4 = \frac{\text{Required Net Income} + \text{Interest Expense}}{\text{Interest Expense}} \\
 &= \frac{\text{Required Net Income} + \$791,791}{\$791,791} \\
 &= \$316,716
 \end{aligned}$$

Required Net Income	\$316,716
+ Adjusted Loss for Test Period	156,726
Required Increase	<u>\$473,442</u>

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION IN CASE NO. 8864 DATED DECEMBER 20, 1983.

The following rates are prescribed for customers in the area served by North Central Telephone Cooperative, Inc. All other rates not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the date of this Order.

GENERAL SUBSCRIBER SERVICES TARIFF

C.1 Local Exchange Service Rates

C.1.2 Monthly exchange service rates as authorized by the Kentucky Public Service Commission.

1. Monthly exchange rates for:

Scottsville

ONE-PARTY SERVICE

RATE COMPONENTS	RESIDENCE	BUSINESS
Network Access Charge	\$13.25	\$19.88

G.1 Public Telephone Service

G.1.3 Message Charges

1. Each local message	0.25
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G.2 Semi-Public Telephone Service

G.2.2 Charges

1. Each local message	0.25
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3. Subscribers to Semi-public Telephones are required to guarantee total monthly receipts from local exchange service of \$19.88. When the monthly receipts from Local Service are less than the amount of the guarantee, the subscriber will be billed for the difference. Such bills are subject to the same terms and conditions and treated as bills rendered for other types Local Exchange Service.

J.3 Charges

Rates:

Monthly Rate

- J.3.1. Each trunk at 1 1/2 times
the one-party bus. rate

Sec. "C"